



**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

DEPARTMENT OF THE TREASURY

**INTERNAL REVENUE SERVICE
TE/GE: EO Examination
1100 Commerce St. - 4920 DAL
Dallas, TX 75242**

501.03-00

May 23, 2011

Number: **201202040**
Release Date: 1/13/2012

LEGEND

ORG - Organization name XX - Date Address - address

ORG

ADDRESS

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to:

Dear :

This is a Final Adverse Determination Letter as to ORG's exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

ORG. not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). ORG also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You have ceased all operations and no longer meet our operational requirements.

Based upon these reasons, we are revoking your IRC section 501(c)(3) tax exempt status to January 1, 19XX. You have signed Form 6018, "Consent to Proposed Action" agreeing to the change.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 19XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling (518) 427-5413, or writing to: Internal Revenue Service, Taxpayer Advocates Office, Leo O'Brien Federal Building, Clinton Ave and N. Pearl St., Albany, NY 12207.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street MC:4900DAL
Dallas, TX 75242

August 18, 2010

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear ,

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

| | | |
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| Form 886A | Department of the Treasury - Internal Revenue Service Explanation of Items | Schedule No. or Exhibit |
| Name of Taxpayer ORG EIN | | Year/Period Ended 19XX12, 19XX12, 20XX12, 20XX12, 20XX12, 20XX12, 20XX12 |
| | | |

LEGEND

ORG - Organization name XX - Date State - state City - city
CO-1, CO-2 & CO-3 = 1st, 2nd & 3rd COMPANIES

ISSUE:

Should the tax-exempt status of the **ORG** as an organization described in section 501(c)(3) of the Code be revoked effective January 1, 19XX, the first day of the period under examination, because its Primary activity is the conduct of an impermissible trade or business?

FACTS:

The **ORG** (Foundation) was incorporated on November 17, 19XX in the State of State. On February 16, 19XX, an Amended and Restated Articles of Incorporation were filed with the Secretary of the State of State and accepted. According to its Amended and Restated articles of incorporation its purposes were:

"To distribute the whole or any part of the income therefrom, and the principal thereof exclusively for charitable, religious, scientific, literary or educational purposes, either directly or by contributions, to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code and Regulations issued pursuant thereto, as they now exist or as they may hereafter be amended."

Subsequently, **ORG** filed an Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code on Form 1023 ("Application"). In the Application, **ORG** stated that it will perform the following programs:

"The Foundation was formed to be a charitable foundation under 501(c)(3) of the Internal Revenue Code. The Foundation will solicit contributions from the general public, primarily in the form of used boats, which will be acquired via bargain purchases. The Foundation will purchase the boats from the donors at a bargain price, and resell them at a marked up price. The profits earned by the Foundation on these resales, after paying for expenses, will be donated to various other Section 501(c)(3) organizations.

The activity was started prior to receipt of tax-exempt status under Section 501(c)(3), so the City chapter of the CO-1 (CO-2) has been accepting the donated boats and the Foundation works in conjunction with CO-2 to resell the boats. Upon receipt of tax-exemption, the Foundation will begin independent operations.

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| | | |

Approximately eighty percent (80%) of time and resources of the Foundation will be used to accept donated boats and resell the boats.

The Foundation's headquarters in City, State will control all financial, legal and administrative functions of the Foundation. The City office space will be donated by CO-2 Three of its officers are also officers of the Foundation and donate their time to the Foundation. A City, State sales office will be subleased from the CO-2 and marina space also located in City is leased on a month to month basis from an independent party. Employees of the Foundation will conduct the State operations, and in addition, a lease agreement was signed on 12/10/XX for the rental of office space in City, State for the conduct of similar business.

The Foundation will also conduct marine activities for the programs or the CO-1 (CO-1) and the CO-3, both Section 501(c)(3) organizations, which provide activities and programs for orphaned children and young adults with developmental disabilities.

The marine activities will include out patient therapy programs, vocational programs, educational programs, recreational programs and Big Brothers/Big Sisters programs designed to address the special needs of the consumers of CO-2 and the CO-3. The activities will consume approximately twenty percent of the Foundations time and resources. The services will begin in June of 19XX and will be conducted at a site yet to be determined by the Foundation.

The Foundation will conduct these marine activities at no charge to CO-2 or the CO-3, so the time and resources of the Foundation used in these activities will be charitable donations to these organizations."

On July 24, 19XX, the Service recognized **ORG** as tax-exempt under Section 501(c)(3) of the Code, with an advance ruling period ended on December 31, 20XX.

The Foundation's primary office was located in City, State with leased space in City, State for office space and mooring of boats. Organization also indicated that they have an independent contractor on the West Coast (State) who conducts same function as the State Office.

During the examination period, the Foundation's charitable expenditures were, on the average, about 2% of its total distributions.

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| | 19XX12 | 19XX12 | 20XX12 | Total |
|---|--------|--------|--------|-------|
| Total Revenue per Form 990, Line 12 ** | | | | |
| Total Expenses per Form 990, Line 17 | | | | |
| Charitable Expenditures | | | | |
| Charitable Expenditures as a % of Gross Revenue | | | | |
| Charitable Expenditures as a % of Disbursements | | | | |

** Total Revenue is Net of Cost of Goods Sold (Line 10B)

Total Gross Revenue from the Sale of Boats

| | 19XX | 19XX | 20XX |
|------------|------|------|------|
| Boat Sales | | | |

The Foundation did not record the boats at fair market value on the date of acquisition. The Boats were recorded at cost and then adjusting entries are made at the end of the year when the value is determined based on the sales price. The Foundation's year-end adjusting entries reflect the adjustments to contributions and year-end boat inventory.

During the examination period, the Foundation's charitable expenditures consisted of the following:

| | 19XX12 | 19XX12 | 20XX12 | Total | Percent |
|------------------------------|--------|--------|--------|-------|---------|
| Charitable Contributions | | | | | |
| Program Expenses | | | | | |
| Boat Excursions for children | | | | | |
| Total | | | | | |

The actual amounts expended for program expenses and boat excursions for children were not separated and are included in the program items

The Foundation sold the donated boats, including boats traded -in, to third parties, including individuals, yacht brokers, and corporations. Several sales to individuals were made through third-party yacht brokers. The actual brokerage fees associated with these boat sales were not determined. The Foundation indicated that the brokers kept closing documents from the boat sales. The Foundation recorded these boat sales net of the brokerage commissions.

In some cases, when the Foundation sold boats, the buyer paid part of the purchase price by "trading-in" another boat. Subsequently, the Foundation would sell these trade-ins in the manner described above.

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| | | |

A review of the Form 8283(Noncash Charitable Contributions) on file at the Foundation indicated that blank forms were signed by the Foundation and given to the donors. The Foundation did hire an appraiser to survey the boats prior to acquisition. Not all boats had the actual survey in the files. Upon request some surveys were provided.

The Foundation filed Form 8282 (Donee Information Return) for the boats that were sold within two years after they were donated. Form 8282 requires that charitable organizations disposing of certain donated property within two years after the donation to file this form reporting certain information relating to the disposition of the donated property.

During the examination period, the Foundation sold some boats in transactions known as "Charter Sales." In a Charter Sale, the Foundation sold the boat to a buyer, who paid the Foundation cash only, or cash plus another boat as a trade-in. Although the Foundation transferred possession of the boat to the buyer, the Foundation retained title to the boat for a period of up to two years (the "Charter Period").

During the Charter Period, the buyer paid all insurance, repairs and maintenance for the boat. After the Charter Period, the Foundation transferred title to the buyer. For the fiscal year ending 19XX the Foundation reported revenue from the Charter Sales on Form 990- T as income from an unrelated trade or business.

During the examination period, the Foundation maintained an average staff of 11 people, including an average of 10 full-time salesmen, plus others who worked part-time. The Foundation treated these salesmen as independent contractors during 19XX and converted most of the salesmen to employees in 19XX. Salesmen obtained contributions of boats and arranged for their sale. Commissions were paid for both donations and boat sales. Due to numerous modifications to the commission pay sale, the audit did not determine any specific basis for commissions.

The original application for exemption indicated that salesmen would be paid a base salary of \$ with commissions of % of sales price of any boat solicited which gets sold and % of sales price for any boat that they sell.

A memo dated February 23, 19XX indicated that commissions would be paid to persons who got the donation and the sales person who made the sale will each receive % of the net profit. Therefore the company would have paid % profit on any boat in the form of commissions. Exceptions were made for two individuals. The first person listed would receive % on all boats

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brought in and the second person (who apparently was office personnel) would receive a % commission on boats she helped to obtain.

A review of the Salesmen Draw vs. Commissions analysis for 19XX indicated that commissions ranged from %, % plus NP, %, % (net profit).

A review of the Salesmen Draw vs. Commissions analysis for 20XX indicated that commissions ranged from %, % don comm..., % manager commission, % sales commission and % sales price.

Commissions paid to the staff differed from commissions paid to Brokers. Brokers involved in the solicitation of the boat as a donation also received commissions. There were several boat transactions where brokers received a commission for both soliciting the donation of the boat and the sale of the boat.

| Boat | Amount Paid to Donor | Broker Commission On Acquisition | Sales Price | Broker Commission On Sale |
|------|----------------------|----------------------------------|-------------|---------------------------|
| A | | | | |
| B | | | | |
| C | | | | |
| D | | | | |
| E | | | | |
| F | | | | |

During the examination period, the number of boats donated to the Foundation and the number of boats the Foundation sold were:

| | 19XX | 19XX | 20XX | Total |
|--|------|------|------|-------|
| Boats as Contributions Only | 13 | 14 | 15 | 42 |
| Boats Donated in Bargain Purchase Transactions | 76 | 64 | 85 | 225 |
| Total Boats Donated & Bargain Purchase | 89 | 78 | 100 | 267 |
| Boats Sold | 75 | 64 | 65 | 204 |

During the examination period, the average number of days between the time when boats were donated to the Foundation, or received as trade-ins, and the time when these boats were sold was:

| 19XX | 19XX | 20XX |
|------|------|------|
| 75 | 100 | 60 |

| | | |
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| | | |

At the present time, the Foundation is no longer engaged in active operations, and has stated their intent to dissolve the corporation.

LAW:

Section 501(c)(3) of the Code provides an exemption from income taxes for organizations which are described in section 501 (c) of the Code.

Section 501 (c)(3) of the Code describes the type of organization that are entitled to exemption as a charitable organization only if the organization is organized and operated exclusively for religious or charitable purposes with no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Income Tax Regulations section 1.501(a)-1(c) provides that the words "private shareholder or individual" means persons having a personal and private interest in the activities of the organizations.

Income Tax Regulations section 1.501(c)(3)-1(c)(2) provides in part that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Income Tax Regulations section 1.501(c)(3)-1 (d)(l)(ii) states that an organization is not organized or operated exclusively for one or more charitable purposes unless it serves a public rather than a private interest.

To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

If any organization fails to meet either the organizational test or the operational test, it is not exempt.

Income Tax Regulations section 1.501(c)(3)-1(d)(l)(ii) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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Income Tax Regulation section 1.513-1 (d)(2) provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513 of the Code only if the causal relationship is a substantial one. For this relationship to exist, the production of distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

GOVERNMENT POSITION:

Based on the facts described above and the application of the pertinent law our position is that the organization is operated in a commercial manner. The organization has not provided documentation to substantiate that its activities were related to its exempt purpose. Thus, the organization operated to serve the private interest of this individual rather than a public interest. The organization is not currently in active operation, and does not meet the operational test.

TAXPAYER POSITION:

The taxpayer has ceased operations and has agreed to the revocation of exemption under Section 501(c)(3) of the Internal Revenue Code. The organization has signed and returned Form 6018. Consent to Proposed Action

CONCLUSION:

Based on the facts of this case the organization has failed to establish that it is operated exclusively for an exempt purpose. Therefore it is not entitled to exemption under section 501(a) as an organization described in section 501 (c)(3) as of January 1, 19XX.